



## Key issues and options for preliminary drafting on agriculture

		Ministry for Primary Industries Manatū Ahu Matua	
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	<b>Action sought:</b>	<b>Response by:</b>
To: Hon James Shaw, Minister for Climate Change and Hon Damien O'Connor, Minister of Agriculture	Feedback and agreement	9 August 2019

Actions for Minister's Office Staff	<b>Return</b> the signed report to MfE and MPI.
Number of appendices and attachments 2	Titles of appendices and attachments (ie separate attached documents): 1. Key drafting issues: Default settings and alternative options 2. Minor drafting issues and policy implications
Note any feedback on the quality of the report	

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# Key issues and options for preliminary drafting on agriculture

## Key Messages

1. This briefing provides:
  - a. advice on key issues and options for preliminary drafting on agriculture for inclusion in the Climate Change Response Amendment Bill (the Bill)
  - b. information on minor drafting issues and their policy implications for your feedback.
2. This briefing also recommends that you meet with relevant ministerial colleagues as soon as possible to inform preliminary drafting instructions and expedite the process towards final policy decisions on agriculture.

### ***Preliminary drafting has begun based on the legislative proposals agreed by Cabinet***

3. The Parliamentary Counsel Office (PCO) is preparing preliminary drafting based on the legislative proposals agreed by Cabinet for public consultation [ENV-19-MIN-0039 and CAB-19-MIN-0337 refer]. The proposals respond to the Interim Climate Change Committee's recommendations for action on agricultural emissions.
4. Cabinet agreed to preliminary drafting and a short, focused consultation so that legislative changes on agriculture could be included as soon as possible for the introduction of the Bill by the end of September, or shortly after at the beginning of Select Committee.
5. Consultation is underway from 16 July-13 August. We note final policy decisions and legislative proposals remain subject to further advice on the results of public consultation and a regulatory impact assessment (RIA) of the available policy options.

### ***There are alternative options to the default minimum changes currently being drafted***

6. Preliminary drafting includes the minimum changes required to price livestock emissions at farm level and fertiliser emissions at processor level in the Emissions Trading Scheme (ETS) from 2025. There are also two proposals for an interim policy measure:
  - **Option A:** processor-level obligations in the ETS at 95 percent free allocation
  - **Option B:** a formal sector-government agreement.
7. Both interim proposals include a programme of action with the sector and iwi/Māori to support the move to farm-level pricing. A ministerial report to Parliament is also proposed in 2022, which will be informed by this programme of action. Therefore, some of the more complex farm-level decision-making and drafting can be deferred to 2023/24.
8. However, other key drafting issues require your attention and direction now. There are alternative legislative options that could be preferable to the default settings in the Act, which would turn on automatically under Option A (interim ETS). These default settings, alternative options and officials' recommendations are summarised in Appendix 1.
9. We are not considering legislative drafting to support the interim sector-government agreement in Option B. Depending on the mechanism used to record the agreement, this creates a risk of its range of commitments not being legally enforceable. One option to mitigate this risk is including a provision for the Government to bring in a processor-level scheme by Order in Council at any time prior to 2025, in the event the agreement's commitments and key milestones are not met. This would require relatively simple legislative changes and could achieve similar results. Other more complex options for supporting the agreement (or aspects of it) in legislation would require some development. This would risk delaying timeframes for agriculture within the Bill.
10. This briefing also provides information on other minor drafting issues and their policy implications in Appendix 2. We recommend providing any feedback on these minor issues as soon as possible to assist with the preliminary drafting process.

***We recommend you provide feedback and meet with relevant colleagues as soon as possible in order to meet the tight timeframes***

11. Under current timeframes, there is significant time pressure on analysing and summarising public submissions, delivering policy advice and making final decisions on agriculture, in order to introduce the Bill by the end of September (see **Table 1** below).
12. We recommend you meet with ministerial colleagues as soon as possible (including Hon David Parker and Hon Shane Jones) to discuss the key drafting issues and expedite the process towards agreeing final policy decisions on agriculture. These decisions will continue to be informed by public consultation and officials' first best advice. However, this meeting will ensure key ministers are well informed of the range of legislative options, including their risks and trade-offs.
13. Should final policy decisions be delayed, there are other options for including agriculture without delaying the introduction or enactment of the Bill. These include signalling decisions at the beginning of Select Committee and/or introducing an SOP at a later stage.

**Table 1. Proposed timeframes for agriculture in the Climate Change Response Amendment Bill**

<b>Key deliverable</b>	<b>Deadline</b>	<b>Drafting notes</b>
Consultation closes	13 August	
Final CAB paper to you (including draft submissions analysis but excluding RIA)	21 August	<i>PCO drafting in parallel</i>
Formal ministerial consultation	22–28 August (5 days minimum)	
CAB final policy decisions (including final RIA and submissions analysis)	2 September	<i>Minimum 10-day BORA vetting of Bill</i>
LEG Committee	17 September	
CAB approves legislation	23 September	<i>Final Bill drafted and added to Parliament website</i>
Introduction of the Bill	End of September 2019	

## Recommendations

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We recommend that you:

- a. **Note** initial instructions have been provided to the Parliamentary Counsel Office for preliminary drafting based on the legislative proposals agreed by Cabinet for public consultation [ENV-19-MIN-0039 and CAB-19-MIN-0337 refer]
- b. **Provide** feedback as soon as possible on:
  - i. key drafting issues, including default settings, alternative options and officials' recommendations, which are summarised in Appendix 1  
Yes/No
  - ii. minor drafting issues and their policy implications discussed in Appendix 2  
Yes/No
- c. **Note** there is significant time pressure associated with including decisions on agriculture for the introduction of the Climate Change Response Amendment Bill by the end of September (see Table 1 in this briefing)
- d. **Note** preliminary drafting does not currently provide for the interim sector-government agreement in legislation, and providing for this in legislation would risk delays to current timeframes for the introduction of the Bill
- e. **Agree** to meet with relevant ministerial colleagues, including Hon David Parker and Hon Shane Jones, to discuss the key drafting issues in this briefing and expedite the process towards making final policy decisions  
Yes/No
- f. **Agree** to meet with officials to discuss this briefing further, prior to meeting with ministerial colleagues  
Yes/No

## Signature

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Chris Kerr,  
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Hon James Shaw  
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Date

Hon Damien O'Connor  
**Minister of Agriculture**

Date

# Key issues and options for preliminary drafting on agriculture

## Supporting material

### Purpose

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14. This briefing provides:
- a. advice on key issues and options for preliminary drafting on agriculture for inclusion in the Climate Change Response Amendment Bill (the Bill)
  - b. minor drafting issues and their policy implications for your feedback.
15. We recommend you meet with relevant ministerial colleagues, including Hon David Parker and Hon Shane Jones, to discuss the legislative policy options and assist in expediting the process towards final policy decisions on agriculture.

### Context

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16. The Parliamentary Counsel Office (PCO) is currently preparing preliminary drafting based on the legislative proposals agreed by Cabinet for consultation [ENV-19-MIN-0039 and CAB-19-MIN-0337 refer]. Short, focused consultation began on 16 July and is underway until 13 August. The Government's proposals respond to the Interim Climate Change Committee's (Interim Committee) recommendations for treating agricultural emissions.
17. Cabinet agreed to a short, focused consultation and preliminary drafting so that legislative changes on agriculture could be included as soon as possible for the introduction of the Bill, or shortly thereafter at the beginning of Select Committee.
18. We note final drafting on agriculture remains subject to final policy decisions by Cabinet. Final decisions will be informed by submissions received during consultation, as well as officials' regulatory impact assessment of the range of available policy options.
19. The proposals for preliminary drafting reflect the long-term objective of pricing agricultural emissions at the farm level. However, they also acknowledge reservations around the feasibility and cost-effectiveness of farm-level pricing. The proposals include:
- a. enabling farm-level surrender obligations for livestock emissions in the Emissions Trading Scheme (ETS) from 2025
  - b. applying voluntary farm-level reporting on livestock emissions from 2023 and mandatory reporting from 2024
  - c. requiring the responsible ministers (for climate change and agriculture) to table a report in Parliament by 2022 on:
    - i. the feasibility of farm-level pricing by 2025, including the core design features of a farm-level scheme and any legislative and regulatory amendments required; and
    - ii. whether an Order in Council is required to price livestock emissions at the processor level instead, if not feasible at the farm level.
20. Preliminary drafting also provides for two proposals to encourage action on reducing agricultural emissions in the interim:
- **Option A (interim ETS):** processor-level surrender obligations in the ETS from 2021 (as recommended by the Interim Climate Change Committee)

- **Option B (interim agreement):** a formal agreement between the Government and sector (based on the Primary Sector Leaders Group’s proposal for a five-year Programme of Action).
21. You requested, and Cabinet agreed, that PCO begin drafting the minimum changes required to the Climate Change Response Act (the Act) for both interim proposals. We have sent the initial drafting instructions for these minimum changes to PCO.
  22. Some of the more complex farm-level decision-making and drafting will need to be deferred to 2023/24, following the 2022 report. This allows more time to work closely with the sector and iwi/Māori to develop the necessary farm-level policy settings and tools. The 2022 report will also discuss the additional legislative and regulatory amendments required.
  23. However, some key drafting issues require your attention and direction now. The default settings in the Act would automatically enter into force once processor-level obligations are introduced for agriculture. There are alternative legislative options, some of which could be preferable to the default settings in the Act. However, further additional legislative changes to the Act may risk delays to current timeframes for introduction of the Bill this year.
  24. The default settings and their alternative options are discussed in our advice below and summarised in the diagram in Appendix 1.
  25. We note preliminary drafting does not currently include changes to reflect the formal sector-government agreement in legislation (e.g. funding, governance, implementation or compliance). Depending on the mechanism used for the agreement, there is a risk its range of commitments would not be legally enforceable.
  26. One option to mitigate this risk is including a provision for the Government to bring in a processor-level scheme by Order in Council at any time prior to 2025, in the even the agreement’s commitments and key milestones are not met. This would require relatively simple legislative changes and could achieve similar results. Other more complex options for supporting the agreement (or aspects of it) in legislation would require some development and, therefore, risk delaying timeframes for the introduction of the Bill.

## Analysis and Advice

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27. There are three key remaining legislative issues, all of which relate to free allocation to agriculture:
  - i. level of free allocation
  - ii. phase-out rate for free allocation
  - iii. process for decisions on phase-out.
28. The options for each key issue are discussed below, and their pros and cons are summarised in the diagram in Appendix 2.

### Level of free allocation

29. The level of free allocation to agriculture refers to the amount of units in the ETS provided at no extra cost to processors from 2021 (Option A only) or to farmers from 2025 (both Options A and B).<sup>1</sup> The default level currently in the Act is 90 percent, which is calculated as a proportion (i.e. a discount) of an eligible participant’s estimated emissions.
30. The purpose of free allocation to agriculture would be to mitigate the potential costs and impacts of emissions pricing on the sector, rural communities and iwi/Māori. This is different from the purpose of industrial allocation, which is to maintain international

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<sup>1</sup> If the 2022 report found farm-level pricing to be unfeasible, the point of obligation would revert to processor level.

competitiveness and reduce the risk of emissions leakage. The Interim Committee considered the risk of emissions leakage to be relatively low for agriculture.

31. The Labour-New Zealand First Coalition Agreement commits the Government to providing 95 percent free allocation, if ETS surrender obligations are introduced for agricultural methane and nitrous oxide emissions. The default settings in the Act for free allocation to agriculture are currently suspended; the Act must be amended to change the level of free allocation to agriculture from 90 percent to 95 percent.
32. Modelling suggests 95 percent free allocation at processor level would achieve limited emissions reductions of around 0.26 percent per year, assuming modest reductions in milk and meat production and a small increase in afforestation.<sup>2</sup> Without phase-out (see below) or an increase in the \$25 per-tonne emissions price, there is a risk this modest price incentive could remain in the medium to long term (i.e. once farm-level obligations start in 2025).  
s9(2)(g)(i)
33. As discussed, preliminary drafting would amend free allocation to agriculture in the Act from 90 percent to 95 percent to reflect the Coalition Agreement. For the purposes of preliminary drafting, we recommend including the level of free allocation as a key consideration in the 2022 report on farm-level pricing.

#### Phase-out rate for free allocation

34. The rate of phase-out (also known as 'phase-down') is the rate at which the level of free allocation is changed over time. The purpose of phase-out would be to ensure there is a sufficient price incentive in place, which should be aligned with the emission budgets and targets set under the Zero Carbon Amendment Bill and New Zealand's NDC.
35. Any change to the level of free allocation should be informed by robust, objective analysis, including on potential economic and social impacts on rural communities. The Interim Committee recommended phase-out should be well signalled and predictable, and that decisions on phase-out could be informed by advice from the independent Climate Change Commission (the Commission).
36. The Act currently sets free allocation to agriculture to phase down by 1 percent per annum after the first year of surrender obligations. However, the Act also provides for a temporary suspension on phase-out, which may be lifted by a specific date by Order in Council.
37. Alternative options to the default settings in the Act include:
  - a. repealing the temporary suspension (1% per annum would begin automatically)
  - b. aligning with the phase-out rate for industrial allocation (1% per year from 2022-2030; 2% per year from 2031-2040; and 3% per year from 2041-2050)
  - c. repealing the phase-out rate altogether.
38. If the level of free allocation to agriculture is set at 95 percent, we recommend keeping the default phase-out rate and temporary suspension currently in the Act. This allows flexibility for the 1 percent phase-out to be initiated by Order in Council, if and when necessary, to allow the price incentive to increase gradually over time. This option also provides opportunity for a robust analysis of the costs and impacts of phase-out across the economy before any decisions are made. We consider repealing the current phase-out provisions altogether presents a slightly higher risk as it would remove this flexibility.

<sup>2</sup> Manaaki Whenua Landcare Research. (2019). Modelling of agricultural climate change mitigation policy scenarios.

39. However, the default settings do not provide flexibility for the phase-out rate to be changed from 1 percent once initiated. Therefore, we would also recommend, for the purposes of preliminary drafting, including the phase-out rate in the list of key considerations for the 2022 report. This would enable the Government to amend the 1 percent phase-out rate if another rate or approach was considered more appropriate. This would also ensure the phase-out rate was considered alongside other important farm-level policy settings, such as the level and method of free allocation.

### **Process for decisions on phase-out**

40. As noted, decisions on phase-out have significant implications and require careful consideration. If the default settings for phase-out were repealed, we would recommend outlining the process for decisions on phase-out in legislation (as the Interim Committee also recommended). If no additional primary legislation was passed, this could help to avoid the cost of targets falling inequitably and inefficiently on taxpayers and/or other sectors of the economy.
41. An alternative process could be providing for decisions on phase-out to be made by Order in Council (i.e. a regulation-making power). We do not recommend this option, as it carries a high degree of uncertainty and unpredictability for the sector and other policy settings. Furthermore, significant decisions such as free allocation are typically set in primary legislation, as each regulatory decision comes with a risk of judicial review.
42. Another alternative is requiring the Commission to provide advice on the phase-out rate for agriculture. There is some precedent for this: in other proposed changes in the Bill, the Commission will be required to advise on pausing the phase-out of industrial allocation (but only as this relates to a risk of emissions leakage).
43. The independent Commission's advisory and monitoring role will be important for holding the Government to account on meeting New Zealand's budgets and targets. If the Government chose this option, we would recommend including specific conditions the Commission would be required to take into account in its advice, including implications for climate change targets, economic and social impacts on rural communities and iwi/Māori, and any risks for international competitiveness and emissions leakage.
44. As noted, for preliminary drafting, we also recommend including the process for decisions on phase-out as one of the key considerations in the 2022 report. Requiring ministers to include phase-out in their report to Parliament on farm-level pricing will ensure it is considered alongside the other significant farm-level allocation settings and policies. It will also ensure that any subsequent decisions are based on a robust analysis of their potential economic and distributional impacts, and signalled well in advance of farm-level pricing.

### **Minor drafting issues and policy implications**

45. In addition to the key drafting issues above, there are other minor issues related to the preliminary drafting currently being prepared by PCO.
46. We outline these minor drafting issues and their policy implications in Appendix 2. These include some of the minimum changes required to the Act for preliminary drafting, as requested, as well as other changes with less significant implications that we consider necessary to update the legislation and ensure it is workable and effective.
47. We provide officials' position and rationale for each. As we will be preparing drafting instructions for PCO on this basis, we recommend providing feedback as soon as possible to ensure we meet your expectations and the tight timeframes.



## Consultation and Collaboration

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48. This is a joint agency briefing between the Ministry for the Environment and Ministry for Primary Industries. Our respective legal departments have reviewed the legislative proposals and implications in this paper (see **Legal issues**, below).

## Risks and mitigations

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49. There is a general risk of delay to the legislative process for the Bill, due to the particularly short timeframe for ministerial consensus on final policy decisions on agriculture and the major drafting issues discussed in this briefing. This could either delay the Bill's introduction into the House altogether (perhaps further into 2020) or delay the inclusion of agriculture as part of the Bill and throughout the Select Committee stage.
50. It is critical we receive your feedback as soon as possible to include this in PCO's preliminary drafting instructions. It could be useful to discuss the key drafting issues with your Cabinet colleagues, including Hon David Parker and Hon Shane Jones, in order to expedite the process towards making final policy decisions.
51. We note public consultation is currently underway. There is a risk preliminary drafting instructions could be perceived as pre-empting Cabinet decision-making without considering public, iwi/Māori and stakeholder views. This risk is somewhat mitigated already by PCO drafting all legislative proposals in parallel. We can further mitigate this risk by incorporating the results of public consultation and submission analysis as part of our advice on final policy decisions.

Withheld under s9(2)(h)



## Financial, regulatory and legislative implications

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55. As noted, decisions on agriculture have significant economic and financial impacts, as well as timing implications for progressing the Bill through the House.
56. The Bill is currently expected to be introduced by the end of September. This could be with or without final policy decisions on agriculture. If agriculture decisions are delayed, these

could be provided as soon as possible at the beginning of Select Committee or as a fully drafted Supplementary Order Paper (SOP). The further into Select Committee, however, the less opportunity there will be for consultation on any draft legislation on agriculture.

57. A Regulatory Impact Assessment (RIA) will be provided with the Cabinet paper seeking final policy decisions. The RIA will include analysis of the available policy options, including economic modelling of various policy scenarios, and a more detailed cost-benefit analysis of officials' preferred approach.

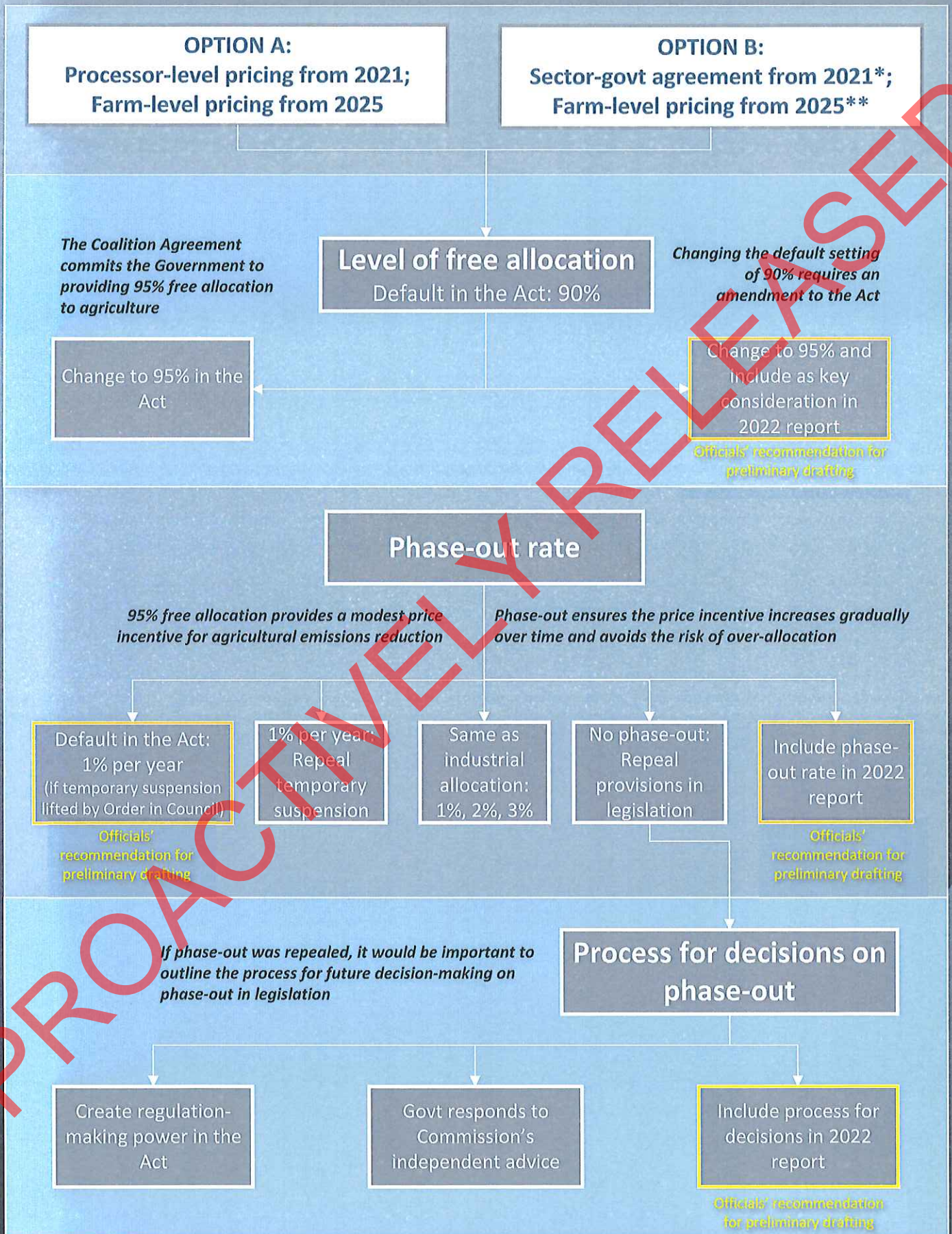
### Next Steps

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58. Your feedback is required on this briefing as soon as possible, particularly regarding the key drafting issues in Appendix 1. Your feedback on these key issues (as well as the minor issues in Appendix 2) will assist in expediting the process towards final policy decisions and including agriculture in the introduction of the Bill.
59. We recommend you meet together with relevant colleagues, including Hon David Parker and Hon Shane Jones, as soon as possible to discuss the key drafting issues. Before doing so, we recommend you meet with officials to discuss this briefing further.
60. As part of consultation, the Ministry for the Environment's website points tentatively to final advice on agriculture in September and the introduction of the Bill by the end of 2019. These dates are indicative only for public consultation, but they provide some expectation of the timeframes for the Bill and decisions on agriculture within it.
61. For other aspects of the Bill, we understand decisions have been made and drafting is well underway. We can advise on the proposed course of action for the Bill in the event that final policy decisions on agriculture are not agreed by the end of September.

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# Appendix 1: Key drafting issues and options for agriculture in the Climate Change Response Amendment Bill



\* No drafting proposed for sector-govt agreement outside legislation. Officials can provide advice on legislative options as required.

\*\* If farm level deemed unfeasible by 2022 report, point of obligation reverts to processor level

PROACTIVELY RELEASED

## Appendix 2. Minor drafting issues and policy implications

Issue and section of the Act	Default policy implications	Officials' position for preliminary drafting and rationale
Definition of processor and farmer and agricultural activities (Schedule 3)	<p><b>Processor-level:</b> Processors and exporters face surrender obligations, including livestock producers and exporters (dairy, sheep and beef, deer, pigs, horses and poultry) and importers and manufacturers of synthetic nitrogen fertilisers.</p> <p><b>Farm-level:</b> Livestock farmers (dairy, sheep and beef, deer, pigs, horses and poultry) face surrender obligations. Fertiliser remain at processor level.</p>	<p><b>Retain:</b> We recommend retaining the definition of agricultural activities and participants for a processor-level ETS. Horses, pigs and poultry represent only 0.25% of total emissions, but eligible participants from these sectors are likely to be comparable in size to other existing ETS participants.</p> <p>For farm-level definitions of agricultural activities, we recommend including this for further consideration in the 2022 report.</p>
Emission factors (s 85 of the Act and in the Climate Change (Agriculture Sector) Regulations 2010)	<p>The calculation of methane and nitrous oxide emissions per unit of output is based on the internationally recognised metric for the gases' global warming potential over a 100-year timeframe (GWP<sub>100</sub>).</p> <p>The emission factors currently set in regulations need to be updated to reflect the most recent estimates for livestock and fertiliser, and will be updated in regulations prior to pricing coming into effect.</p>	<p><b>Retain:</b> While some argue other metrics such as GWP* could better reflect methane's cost due to its short-lived impact on global warming, we have yet to investigate its use in a policy context, including alignment with targets and international policy.</p> <p>We recommend including the pricing of methane and calibration to targets as another of the key considerations in the 2022 report.</p>
Technical adjustment of livestock allocative baseline (s 85(2))	<p>Under the output-based method, the allocative baseline is set by regulation per unit of output (based on national averages) to determine the amount of allocation provided.</p> <p>Instead of updating allocative baselines through regulations, the Interim Committee recommended that a process for updating these be set in legislation.</p>	<p><b>Retain:</b> Officials agree a legislated process for updating allocative baselines could be preferable, both for ensuring greater certainty for participants and avoiding the risk of over-allocation.</p> <p>However, there is limited opportunity to investigate legislative options without delaying timeframes for the Bill's introduction. We recommend:</p> <ul style="list-style-type: none"> <li>• Option A: updating emission factors (for surrender obligations and allocative baselines) through regulations prior to 2021</li> <li>• Option B: considering these issues in the 2022 report as part of farm-level allocation settings.</li> </ul>
No provisional allocation to agriculture, only year-end allocation (ss 81-84)	Participants eligible for industrial allocation are entitled to provisional allocation of units before they are surrendered.	<p><b>Retain:</b> Provisional allocation to agriculture would align with the approach to industrial allocation, but could also increase volume risks in the ETS. Officials have not yet been able to assess whether the benefits of</p>

Issue and section of the Act	Default policy implications	Officials' position for preliminary drafting and rationale
	Agricultural participants do not have this same entitlement in the Act. Free allocation would be provided at the same time as units are surrendered.	amending the Act to allow for provisional allocation to agriculture outweigh the risks to the integrity and predictability of the ETS.
Ability to switch from a processor to a farmer point of obligation by regulation (ss 2A-2C)	Surrender obligations could be switched from processor to farm level at any point, if recommended by the Minister for Climate Change and approved by Cabinet via regulations (Order in Council).	<b>Retain:</b> This provision allows for flexibility. In the event that farm-level pricing is not feasible by 2025, it could be necessary to enable a farm-level point of obligation at a later date.
Calendar year reporting requirements and timeframes (ss 65-66, 118)	This would require participants to calculate and report emissions for the 1 January-31 December calendar year and to submit emissions returns to the EPA by 31 March the following year.	<b>Retain:</b> While it could be beneficial to amend the reporting timeframes at farm level to align with the farming calendar year (e.g. from mid-year), these provisions would be acceptable in the interim processor-level period.
Transitional provision for penalties (s 217)	Agricultural participants would not face penalties for reporting omissions or errors in the first year of surrender obligations (i.e. 2021 in Option A; 2025 in Option B).	<b>Amend:</b> The transitional provision should be revoked for processors, who have been required to report in the ETS since 2012. We recommend retaining this provision at the farm-level to encourage reporting and allow for the correction of reporting errors and system flaws in the first year.

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